This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS YEREVAN 001781

SIPDIS

SENSITIVE

DEPT FOR EUR/CACEN-ESIDEREAS, EUR/ACE-MLONGI, EB/CBA

E.O. 12958: N/A
TAGS: ECON EFIN AM
SUBJECT: ARMENIAN INFLATION: CENTRAL BANK IN A CORNER

Ref: Yerevan 1651

¶1. (U) Sensitive but unclassified. Please protect accordingly.

¶2. (SBU) Summary. A rising tide of dollars in the economy is forcing Armenia's Central Bank to choose between an appreciated local currency or increased inflation. Although it is choosing to let the Dram rise, inflation nevertheless exceeds the 3 percent target. End Summary.

EXTRA DOLLARS DRIVE DRAM APPRECIATION

¶3. (U) Extra dollars are coming from both outside and inside the country, raising the value of the Dram against the dollar. From inside, a significant increase in dollar-denominated commercial and consumer lending by banks has taken dollars from bank vaults and put them on the street. Recent economic growth and better business expectations have attracted non-bank dollar savings from houses into investments. From outside, foreign investments, remittances and private transfers, as well as tourism income have contributed to the expansion of the dollar supply. The Dram's rapid appreciation against the dollar, which makes exports uncompetitive and causes instability in the heavily dollarized economy, makes matters difficult for the CBA. There is political pressure on the CBA to intervene to stabilize the Dram but it cannot put Drams on the market without further fueling inflation or raising interest rates, both undesirable.

CENTRAL BANK UNLIKELY TO MEET INFLATION TARGET

¶4. (SBU) Although the CBA decreased the real (Dram) money supply by 3 percent for the first half of 2004, the economy posted 7.6 percent year-on-year inflation, due to an expanding economy and increases in the price of imported staple goods. Nerses Yeristyan, Advisor to the Chairman of the CBA, told us recently that meeting the inflation target of 3 percent is going to be "a very difficult task." The CBA claims that 50 percent of the money transactions in the economy are in currency other than the Dram, and are thus outside the CBA's control. Whether or not political pressure forces the CBA to intervene to keep the Dram from appreciating, if will be difficult to meet the 3 percent inflation target.
GODFREY